

Implications of WTO Disciplines for Special Economic Zones in Developing Countries

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Abstract

Many developing countries operate geographically delineated economic areas in the form of export processing zones, special industrial zones, or free trade zones. This paper provides an overview of the application of World Trade Organization disciplines to incentive programs typically employed by developing countries in connection with such special economic zone programs. The analysis finds that the disciplines under the Agreement on Subsidies and Countervailing Measures have the most immediate relevance for middle-income World Trade Organization members that are not exempt for certain “grandfathered” programs, but will also concern other developing countries in the future, as their exemption expires or their per-capita income passes a threshold of US\$1,000. Incentives related to special economic zones can be broadly grouped into three

categories: (i) measures that are consistent with the World Trade Organization, notably exemptions from duties and taxes on goods exported from special economic zones; (ii) measures that are prohibited or subject to challenge under World Trade Organization law, notably export subsidies and import substitution or domestic content subsidies; and (iii) and measures where World Trade Organization consistency depends on the facts of the particular case. The paper provides a set of recommendations on how to eliminate questionable incentives. The single most important zone policy reform to achieve World Trade Organization compliance is to remove all requirements to export and permit importation of goods manufactured in special economic zones into the national customs territory without any restrictions other than the application of import duties and taxes.

This paper—a product of the International Trade Department, Poverty Reduction and Economic Management Network—is part of a larger effort in the department to assess the characteristics and performance of special economic zones in developing countries. Policy Research Working Papers are also posted on the Web at <http://econ.worldbank.org>. The authors may be contacted at pwalkenhorst@worldbank.org.

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***IMPLICATIONS OF WTO DISCIPLINES FOR
SPECIAL ECONOMIC ZONES IN DEVELOPING COUNTRIES***

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Acronyms and Abbreviations

DDR	Doha Development Round of multilateral trade negotiations
DR	Dispute Resolution
DSB	Dispute Settlement Body of the WTO
DSU	Dispute Settlement Understanding of the WTO
EPZ	Export Processing Zone
FTZ	Free Trade Zone
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
LDC	Least Developed Country
MFN	Most Favored Nation treatment
MIC	Middle-Income Country
OECD	Organisation of Economic Co-operation and Development
SCM	Subsidies and Countervailing Measures
SCMA	Subsidies and Countervailing Measures Agreement
SDT	Special and Differential Treatment for Developing Countries
SEZ	Special Economic Zone
TPR	Trade Policy Review of the WTO
TRIMs	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Intellectual Property Rights
WCO	World Customs Organization
WTO	World Trade Organization

Executive Summary

Many developing countries operate geographically delineated economic areas in the form of export processing zones, special industrial zones, or free trade zones. They experiment in these special economic zones (SEZs) with infrastructure, regulatory, and fiscal policies that are different from those implemented in the rest of the domestic economy with the aim of attracting foreign investment, creating employment opportunities, and boosting exports. **Special incentives for zone-based firms play a prominent role in most countries' programs.**

While SEZs are not specifically mentioned by name in any of the multilateral agreements concluded under the auspices of the World Trade Organization (WTO), several types of incentives that are typically part of SEZ policy are subject to disciplines under the WTO, most notably through provisions in the Agreement on Subsidies and Countervailing Measures (SCM Agreement). This Paper provides an overview of the application of WTO disciplines to incentive programs typically employed by developing countries in connection with SEZ programs. **It is intended to inform policy makers, zone administrators, and the development community about the WTO consistency of such incentive measures.** Our analysis is concerned exclusively with multilateral law and leaves economic aspects concerning beneficial or adverse effects of such fiscal incentives aside. As in all legal analysis, different interpretations of particular provisions might be possible and the ultimate decision on the legality of a particular measure remains subject to the authoritative interpretation of the WTO and its Members.

SEZ-related incentives can be broadly grouped into three categories: (i) measures that seem to be WTO consistent, (ii) measures that seem to be prohibited or subject to challenge under WTO law, and (iii) and measures where WTO consistency depends on the facts of the particular case.¹ It should be noted that pursuant to Special and Differential Treatment (SDT), least developed WTO Members and countries whose per capita gross national product is under US\$1,000 in 1990 dollars are currently generally exempt from the disciplines of the Agreement on Subsidies and Countervailing Measures.² Moreover, 16 countries are currently exempt pursuant to phase-out provisions for certain “grandfathered” programs through 2015.³ Hence, **the WTO disciplines have most immediate relevance for middle-income WTO members that are not exempt for certain “grandfathered” programs, but will also concern other developing countries in the future, as their exemption expires or their per-capita income passes the US\$1,000 threshold.**

¹ This terminology echoes the SCM Agreement's terminology of prohibited, actionable, and non-actionable measures.

² The non-LDC countries with a per capita GNP below US\$1,000 US Dollars are: Bolivia, Cameroon, Congo, Côte d'Ivoire, Egypt, Ghana, Guyana, Honduras, India, Indonesia, Kenya, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka, and Zimbabwe.

³ The exempt countries due to “grandfathered” programs are: Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Fiji, Grenada, Guatemala, Jamaica, Jordan, Mauritius, Panama, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, and Uruguay.

Concerning measures that appear WTO legal, **the WTO Agreement on Subsidies and Countervailing Measures excludes from the definition of “subsidy” the core fiscal benefit provided by SEZs** – an exemptions from duties and taxes on goods exported from SEZs. Hence, the following SEZ-related measures appear to be WTO legal:

- Exemption of exported products from import duties;
- Exemption of exported products from indirect taxes;
- Exemption of goods consumed in the production process from import duties and indirect taxes when the end products are exported;
- Exemption of production waste from import duties and indirect taxes when the waste is exported or discarded;
- Exemption of goods stored in SEZs from duties and indirect taxes; and
- Non-specific subsidies, including generally applicable tax rates imposed by national, regional and local government authorities.

Concerning measures employed in connection with SEZ programs that appear inconsistent with WTO disciplines, **two prohibited subsidies identified in Article 3 of the Agreement on Subsidies and Countervailing Measures are of greatest concern: export subsidies and import substitution or domestic content subsidies**. Export subsidies are subsidies that are contingent in law or in fact upon export performance. Domestic content subsidies are subsidies contingent on the use of domestic goods instead of imports. In particular, WTO prohibited government subsidies in connection with SEZ programs include (but are not limited to) the following:

- A direct subsidy contingent on export performance;
- Currency retention schemes involving a bonus on exports;
- Preferential transport and freight charges for export shipments;
- Provision of domestic products and services for exports at terms more favorable than those for domestic goods;
- Exemption, remission or deferral of direct taxes or social welfare charges if contingent on exports;
- Allowance of special direct tax deductions for exports above those granted on goods for domestic consumption;
- Exemption or remission of indirect taxes on exports in excess of those on goods sold for domestic consumption;
- Exemption, remission or deferral of prior stage cumulative taxes on goods or services used in the production of exported products in excess of products sold for domestic consumption (except for the exemption, remission or deferral of such taxes on "inputs consumed" in the production process);
- Provision of export credit guarantees or insurance programs at premium rates inadequate to cover long-term costs;
- Grants of export credits at rates below those which they pay for the funds, or at below market rates, or payment of all or part of the costs of obtaining credit; and
- Subsidies contingent on the use of domestic over imported goods.

Concerning **measures where WTO consistency depends on the facts of the particular case**, there are several types of government policies that fall into this category, for example:

- Duty and tax free treatment of production equipment used in SEZs;
- Provision of materials and components in exchange for compensation that may not reflect full market value; and
- Government subsidies for infrastructure development in an SEZ.

It is important to note that WTO disciplines apply only to measures imposed by WTO Members, i.e., governmental measures. Today, a majority of SEZs are privately owned, developed and operated. Measures imposed by private SEZ operators are not subject to WTO disciplines, unless they implement a governmental measure.

In addition to the provisions of the Agreement on Subsidies and Countervailing Measures, a number of other WTO disciplines may apply to SEZ programs in developing countries. These include Most Favored Nation (MFN) treatment (GATT Article I); national treatment (GATT Article III); the limitation of fees and formalities connected with importation and exportation to the approximate cost of the services rendered (GATT Article VIII(1)); transparency requirements (GATT Article X); the elimination of quantitative restrictions (GATT Article XI); the Agreement on Trade-Related Investment Measures; and the General Agreement on Trade in Services.

This Paper concludes with a set of recommendations on how to achieve WTO compliance regarding government measures employed in connection with SEZ programs. Possibly **the single most important step toward eliminating questionable incentives is removing all requirements to export and permitting importation of goods manufactured in SEZs into the national customs territory without any restrictions other than the application of import duties and taxes.**

In the context of this study, it has not been possible to assess the progress developing countries have made to date in reforming their SEZ fiscal incentive programs to conform to the requirements of the SCM Agreement and other WTO disciplines. This could be a topic for subsequent analyses.

1. Special Economic Zones and the World Trade Organization

The objective of this paper is to provide an overview of World Trade Organization disciplines applicable to fiscal incentives and other measures used by the governments of developing country WTO Members in connection with Special Economic Zones (SEZs).

WTO disciplines are intended to create an open and transparent international trading system in which Members follow rules that generally preclude trade restrictions except for negotiated tariffs. The benefits of the WTO system include increased economic growth, reduction of costs for consumers, universally recognized and applied trading rules, and an effective dispute resolution process.

The basic elements of the WTO system consist of:

- Protection of domestic industries exclusively through tariffs bound against increases;
- Most favored nation (MFN) treatment, requiring that tariffs and regulations be applied without discrimination among Members;
- National treatment, prohibiting discrimination between imported products and domestically produced goods after imported goods are introduced into a Member's economy;
- Rules of general application regarding subsidies, price discrimination, dutiable value, product standards, sanitary and phyto-sanitary regulations, intellectual property, safeguards, and other measures affecting trade in goods;
- An agreement regarding government measures affecting trade in services;
- A dispute resolution understanding that subjects Members found not in compliance with WTO disciplines to possible retaliation; and
- A permanent organization to administer all WTO agreements.

Export subsidies and subsidies contingent on the use of domestic goods are prohibited by the WTO because they have a direct impact on the terms of trade by negating tariffs imposed by importing countries and creating barriers for exports to the subsidizer's or third country markets. Similarly, government measures that are inconsistent with MFN and national treatment principles or are otherwise contrary to WTO disciplines are prohibited.

1.1 Nature and prevalence of SEZs

SEZs are defined in this paper as geographically delimited areas, frequently physically secured, that are usually, but not always, outside the customs territory of the host country. They range in size from single factories to large cities. SEZs are under single management, either government or private-sector. Businesses located within SEZs are normally eligible for benefits such as duty and tax exemptions on goods based on the fact that they are physically located within the zone. Different countries have used different names for zones with these characteristics. These include “‘industrial free zone’ and

‘export free zone’ in Ireland, ‘maquiladora’ in Mexico, ‘duty free export processing zone’ and ‘free export zone’ in the Republic of Korea, ‘export processing zone’ in the Philippines, ‘investment promotion zone’ in Sri Lanka, ‘foreign trade zone’ in India and ‘free zone’ in the United Arab Emirates.”⁴ “Development Areas” can also fit the definition of SEZ.

SEZs are a long-established part of international trade. “Entrepôts,” warehouses where merchandise can be stored, manipulated, and in some cases processed, without the payment of duties and taxes, have existed for many centuries. City-wide free zones on international trade routes were also common. The first modern industrial free zone was established in Shannon, Ireland in 1959. Today, SEZ programs exist in most countries around the world.

Developing countries have increasingly used SEZs as an important economic development tool. A recent survey found over 2,300 SEZs in 119 developing and transition countries around the world.⁵ Starting in the late 1970s, China used SEZs to pioneer new economic policies, provide modern infrastructure and attract investment for export-oriented industries.⁶ A 2008 WTO trade policy review of China found that as of 2006 there were 660 SEZs and other development zones authorized by the central government and an additional 1,346 development zones approved by local governments.⁷ Following the example of China, Vietnam has also extensively used SEZs to introduce new economic policies, provide improved infrastructure and attract investment. As of July 2005, Vietnam had established 124 industrial and export processing zones, attracting 3,612 investment projects amounting to over \$15 billion.⁸ But SEZ proliferation is not limited to Asia, and significant numbers of zones exist in all World Bank regions (Figure 1).

⁴ Michael Engman, Osamu Onodera and Enrico Pinali, *Export Processing Zones: Past and Future Role in Trade and Development*, OECD Trade Policy Working Paper No. 53, TD/TC/WP(2006)39/FINAL, p. 10.

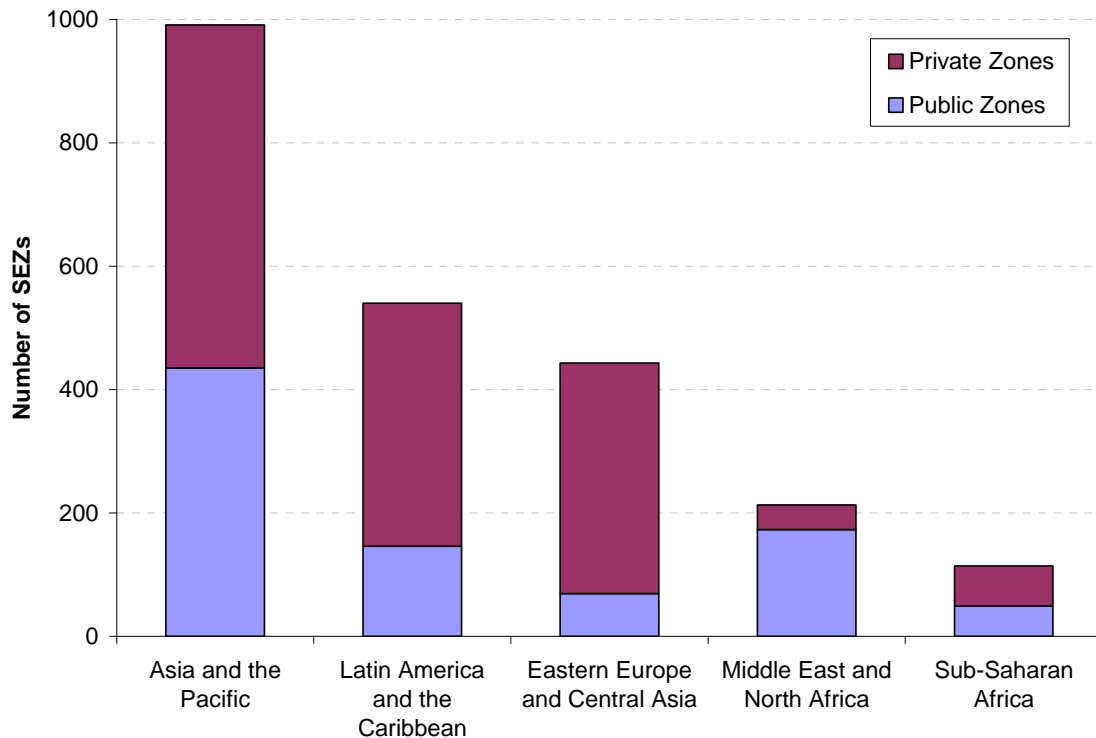
⁵ See Gökhan Akinci and James Crittle, *Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development* (The World Bank Group/FIAS, April 2008).

⁶ See, e.g., Meng Guangwen, *The Theory and Practice of Free Economic Zones: a Case Study of Tianjin, People’s Republic of China* (doctoral thesis, Ruprecht-Karls University of Heidelberg, Germany, 2003); Edward Graham, *Do export processing zones attract FDI and its benefits? The experience from China*, *International Economics and Economic Policy*. (Springer-Verlag 2004).

⁷ Trade Policy Review China, Report by the Secretariat, WT/TPR.S/199 (16 April 2008), Table AIII.5. These zones have various names, such as “Special Economic Zone”, “New Area”, “Open City”, “Border City”, “Free-Trade Zones”, “Export Processing Zones”, “Economic and Technological Development Zones”, “Border Economic Cooperative Areas”, etc. The local zones and some of the national zones listed do not exempt goods in the zone from duties and taxes and therefore do not fall within this Paper’s definition of SEZ.

⁸ Report of the Working Party on the Accession of Vietnam, WT/ACC/VNM/48 (27 October 2006), p. 86.

Figure 1: Large numbers of SEZs exist in all of the world's regions



Source: Akinci and Crittle, 2008.

1.2 The multilateral legal framework for SEZs

SEZs are not specifically mentioned by name in any WTO agreement. However, a footnote to GATT Article XVI and the Agreement on Subsidies and Countervailing Measures excludes from the definition of “subsidy” the core fiscal benefit typically provided by SEZs – an exemption from import duties and taxes on goods exported from SEZs. SEZs as such have not been the subject of any GATT/WTO dispute settlement proceeding, although of course subsidies have and can provide some guidance, and SEZ programs have not been criticized as WTO inconsistent in WTO trade policy reviews.⁹ In at least one recent instance, however, SEZ measures were raised in an accession.¹⁰

Each SEZ comprises a unique configuration of individual measures and as such must be analyzed at the level of these measures. In this regard, certain measures imposed by some Members in connection with SEZ programs may be in conflict with WTO disciplines. Of greatest concern are export subsidies and requirements to use domestic over imported goods.

⁹ See, e.g., Trade Policy Review Report by the Secretariat, China, WT/TPR/S/199 (16 April 2008), pp. 56,80,87 and Table A.III.5.

¹⁰ See, Report of the Working Party on the Accession of Ukraine, WT/ACC/UKR/152 (January 2008), para 338. Compare, Report of the Working Party on the Accession of Viet Nam, WT/ACC/VNM/48 (27 October 2006), pp. 34-35, 86-87. Reportedly, SEZ measures are also an issue in the accession of the Russian Federation to the WTO.

Prohibited and actionable subsidies are governed by the provisions of GATT Article XVI and the WTO Agreement on Subsidies and Countervailing Measures (SCM Agreement or SCMA). Other WTO disciplines may also be applicable to SEZ programs. These include Most Favored Nation (MFN) treatment (GATT Article I); national treatment (GATT Article III); the limitation of fees and formalities connected with importation and exportation to the approximate cost of the services rendered (GATT Article VIII(1)); transparency requirements (GATT Article X); the elimination of quantitative restrictions (GATT Article XI); the Agreement on Trade-Related Investment Measures; and the General Agreement on Trade in Services.

1.3 Earlier analysis on SEZs and WTO disciplines

Two recent useful publications discuss in detail the application of certain WTO disciplines to SEZ programs. In a published article, Mr. Raul Torres, a legal affairs officer in the Development Division of the WTO Secretariat, addresses what Members need to do “to bring...free zones into line with the SCM Agreement”.¹¹ His article does not discuss other WTO disciplines potentially applicable to SEZs. In addition, an OECD working paper regarding export processing zones discusses the application of WTO disciplines to zones.¹² The OECD working paper is limited to a discussion of the SCM Agreement, TRIMs and GATS.

This paper’s analysis of the SCM Agreement’s application to SEZ programs differs from the Torres and OECD publications in four major respects. First, this paper considers the application of specific WTO disciplines to SEZ programs not considered by the earlier papers (e.g., most favored nation treatment, national treatment, the requirement that fees reflect the approximate cost of services rendered, the prohibition on quantitative restrictions).

Second, in their analyses of the application of SCM Agreement disciplines, both prior publications accord relatively little weight to the long established status of zones in international law as areas outside national customs territory and their wide use in both developed and developing countries around the world. As a consequence, both papers narrowly construe SCM Agreement, footnote 1’s specific recognition of “the exemption of an exported product from duties and taxes borne by the like product when destined for domestic consumption” as “not...a subsidy”.

Third, the discussions in both prior publications regarding Article 27.4 export subsidy exemptions for notified programs in certain MIC Members are now out of date. In July 2007, the WTO General Council approved an extension of these exemptions through

¹¹ Raul A. Torres, Free Zones and the World Trade Organization Agreement on Subsidies and Countervailing Measures, *Global Trade and Customs Journal*, vol 2, issue 3 (2007)

¹² Michael Engman, Osamu Onodera and Enrico Pinali, Export Processing Zones: Past and Future Role in Trade and Development,, Part III. EPZ Policy and Trade Rules, OECD Trade Policy Working Paper No. 53, TD/TC/WP(2006)39/Final (23 May 2007).

31 December 2013, with the final two-year phase-out period ending not later than 31 December 2015.¹³

Fourth, this paper applies the basic legal analysis by developing a typology for SEZ incentives according to their WTO consistency (green, amber, and red measures) and presents a set of recommendations to developing country policy makers on how to achieve and maintain WTO compliance.

1.4 Constraints to the analysis and outline

This paper is subject to several constraints. First, the application of WTO disciplines to SEZ fiscal incentives has been analyzed based on typical SEZ government incentive programs. Since each national incentive program is in some respects unique, conclusions based on typical incentives may not be applicable in some instances to specific national programs.

Second, because of limited time and resources it has not been possible to assess the progress developing countries have made to date in reforming their SEZ fiscal incentive programs to conform to the requirements of the SCM Agreement and other WTO disciplines. This could be the topic of subsequent studies.

Third, the opinions expressed in this paper regarding the application or non-application of WTO disciplines to SEZ incentives provided by Members reflect the views of the authors and not necessarily those of WTO Members or the WTO Secretariat. It is possible that a future WTO dispute resolution proceeding could reach different conclusions regarding the application of WTO disciplines to certain SEZ measures than this paper.

The subsequent discussion falls into four parts. Section 2 reviews the WTO Agreement on Subsidies and Countervailing Measures, including any exemptions from the prohibition on export subsidies. Then, Section 3 turns to other WTO disciplines applicable to government measures as applied to SEZ programs. Then, Section 4 synthesizes the previous analysis and classifies typical government incentives used by SEZ programs, such as duty and tax exemptions and tax holidays for businesses and infrastructure improvements, into WTO permitted (green light) incentives, incentives subject to challenge depending upon the particular facts of the program (amber light) and WTO prohibited (red light) incentives.¹⁴ Lastly, Section 5 provides a set of recommendations for changing WTO prohibited measures employed by developing country Members into non-prohibited measures.

¹³ WT/L/691 (31 July 2007).

¹⁴ No conclusions regarding the WTO consistency of existing SEZ programs should be drawn from this Paper as the WTO consistency of individual SEZ programs should be analyzed based on that program's particular law and facts.

2. The Agreement on Subsidies and Countervailing Measures

WTO disciplines regarding subsidies are of greatest concern for SEZ programs in developing countries. In this context, *it is important to note that WTO disciplines apply only to measures imposed by WTO Members,¹⁵ i.e., governmental measures. Today, a majority of SEZs are privately owned, developed and operated.¹⁶ Measures imposed by private SEZ operators are not subject to WTO disciplines unless they implement a governmental measure.¹⁷*

Zones that are outside national “customs territory” to encourage the development of international commerce have existed for many centuries.¹⁸ Import duties and taxes are generally not imposed on goods introduced into these zones, and exports of goods from these zones are also not subject to duties and taxes unless they are imported into that nation’s customs territory.¹⁹ The World Customs Organization’s Revised Kyoto Convention codifies international standards for this practice. The Convention defines “free zone” as “a part of the territory of a Contracting Party where any goods introduced are generally regarded, insofar as import duties and taxes are concerned, as being outside the customs territory.”²⁰

The WCO’s comments to Specific Annex D, Chapter 2 state:

"The establishment of free zones is part of an economic policy that encourages the flow of investment into a Customs territory for manufacturing and other commercial activities. The main purpose of free zones is to promote external trade and international commerce by granting relief from duties and taxes on goods imported to the territory. Additional benefits are the creation of employment in the free zones and the development of associated trade activities.

Goods manufactured in a free zone are often exported. Since exports are generally exempt from duties and taxes, this facilitates and encourages the development of external trade. Domestic goods meant for export can also be admitted to free zones and become entitled to exemption from or repayment of internal duties and taxes. In some administrations when processed goods are

¹⁵ Countervailing duty laws adopted in accordance with the SCM Agreement may, however, apply to subsidized exports from SEZs located in both WTO Member *and* non Member countries, and countervailing duties as per these laws may be imposed in both instances.

¹⁶ See Gökhan Akinci and James Crittle, Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development, *supra*, p. 18.

¹⁷ Fiscal incentives (e.g., exemptions from obligations to pay duties or taxes) generally are established through the domestic law of the host country, and such incentives, even if administered by a private entity, remain government measures.

¹⁸ See, e.g., *Ibid.*, p. 9; World Customs Organization (WCO) Revised Kyoto Convention, Specific Annex D, Chapter 2 (Free Zones).

¹⁹ *Ibid.*

²⁰ Revised Kyoto Convention, Specific Annex D, Chapter 2

removed from free zones for home use, they may sometimes benefit from lower rates of import duties and taxes.”²¹

In recognition of this long established customary practice,²² GATT Ad Article XVI and the SCM Agreement, footnote 1, exclude national measures that exempt exported products from duties and taxes from the definition of “subsidy”.²³

In accordance with the provisions of Article XVI of GATT 1994 (Note to Article XVI) and the provisions of Annexes I through III of this Agreement, the exemption of an exported product from duties or taxes borne by the like product when destined for domestic consumption, or the remission of such duties or taxes in amounts not in excess of those which have accrued, shall not be deemed to be a subsidy.

How broad is this exclusion? Does it cover exemptions of indirect taxes on inputs that are consumed in production and waste? Does it cover exemptions of import duties and taxes on production equipment? Does it cover exemptions of direct taxes and social welfare charges paid by businesses located in SEZs when those exemptions specifically relate to exports? Does it cover the provision by governments of products or services for use in exported goods on terms or conditions more favorable than for the production of goods for domestic consumption? The answers to these questions require a detailed examination of the SCM Agreement.

2.1 Overview of the SCM Agreement and its applicability to SEZ measures

The SCM Agreement establishes multilateral disciplines concerning the provision of subsidies and unilateral countervailing measures imposed to offset injury caused by subsidized imports.²⁴ The Agreement defines the terms “subsidy” and “specific subsidy” and divides all specific subsidies into either prohibited subsidies or actionable subsidies.²⁵ The SCM Agreement provides for special and differential treatment for developing countries and transition rules for formerly centrally-planned economy countries.

Subsidies and specific subsidies. The SCM Agreement defines “subsidy” as a (1) financial contribution (2) by a government or public body (3) conferring a benefit to a recipient.²⁶ In addition, a subsidy must be “specific” to be subject to the disciplines of the Agreement.²⁷ A *de jure* specific subsidy exists when it is explicitly limited to certain

²¹ Comments to the Revised Kyoto Convention (WCO 2003).

²² Customary international law consists of rules derived from the consistent conduct of States.

²³ Footnote 1 also applies to the drawback of duties and taxes and similar customs procedures.

²⁴ See generally, Agreement on Subsidies and Countervailing Measures (“SCM Agreement”), http://wto.org/english/tratop_e/scm_e.htm.

²⁵ The SCM Agreement originally included a third category, non-actionable subsidies, that expired as of 31 December 1999.

²⁶ SCM Agreement, Article 1.

²⁷ Ibid, Articles 1.2, 2.

enterprises. A subsidy that is not *de jure* specific can still be *de facto* specific if it is used only by a limited number of businesses.

There are four types of specificity:²⁸ (1) enterprise specificity; (2) industry specificity; (3) regional specificity; (4) prohibited subsidies. “A subsidy which is limited to certain enterprises located within a designated geographic region within the jurisdiction of the granting authority” is specific.²⁹ This clearly is applicable to subsidies provided to enterprises located within SEZs. In addition, any subsidy falling under Article 3, prohibited subsidies, is deemed to be specific.³⁰

Prohibited subsidies. Two types of subsidies are prohibited by the SCM Agreement: export subsidies and local content subsidies.

Export subsidies are defined as subsidies that are contingent in law or in fact on export performance.³¹ An illustrative list of export subsidies is included in Annex I of the SCM Agreement. Annex I export subsidy programs are summarized below. For the full legal description, the text of Annex I should be consulted:³²

- Direct subsidies to a firm or industry contingent on export performance
- Currency retention or similar schemes involving a bonus on exports
- Internal transport and freight charges for exports on terms more favorable than for domestic shipments
- The provision of goods and services for the use in the production of exported goods on terms more favorable than for the production of like domestic goods, if the terms or conditions are more favorable than those commercially available on the world markets to exporters
- Exemptions, remissions or deferrals of direct taxes or social welfare charges related to exports
- Allowance of special tax deductions related to exports above those granted regarding production for domestic consumption
- The exemption or remission of indirect taxes regarding the production and distribution of exports in excess of those levied on the production and distribution of like products sold for domestic consumption (e.g., excessive remission of value-added taxes).
- The exemption, remission or deferral of prior-stage cumulative indirect taxes on goods and services used in the production of exported products in excess of the exemption, remission or deferral of such taxes levied on like products for domestic consumption. (This is not applicable to prior-stage cumulative indirect taxes levied on inputs that are consumed in the production of the exported product.)

²⁸ Subsidy specificity is assessed at the level of the subsidy-granting authority.

²⁹ Ibid, Article 2.2.

³⁰ Ibid, Article 2.3.

³¹ SCM Agreement, Article 3(a), and Annex I.

³² See Annex G of this Paper for the text of Annex I.

- The remission or drawback of import charges in excess of those levied on imported inputs that are consumed in the production of the exported product. (However, “substitution drawback” is allowed.)
- The provision of export credit guarantee or insurance programs or exchange risk programs at premium rates which are inadequate to cover the long-term operating costs of the programs.
- Grants of export credits at below-market rates or the payment of the costs incurred by exporters or financial institutions in obtaining export credits. (However, certain export credit practices in conformity with the interest rate provisions of the OECD Arrangement on officially supported export credits are not prohibited.³³)

During the first twelve years of the WTO, only one WTO dispute settlement case involved alleged prohibited subsidies maintained by MIC Members. In Brazil-Aircraft, DS46 (1999), Brazil’s payments for aircraft exports under the interest rate component of a Brazilian export financing program (PROEX) was challenged by Canada as a prohibited export subsidy. The Panel and Appellate Body found that the program constituted a prohibited export subsidy and ordered Brazil to withdraw the subsidies within 90 days of the adoption of their rulings.³⁴

Prohibited local content subsidies involve the use of domestic over imported goods.³⁵ Two recent WTO dispute settlement proceedings have involved alleged MIC local content subsidies. In 2007, the United States challenged a number of measures maintained by China providing for refunds, deductions or exemptions from taxes on the condition that enterprises purchased domestic over imported goods.³⁶ Although these benefits were made available to businesses in SEZs, SEZs were not mentioned in the request for an establishment of a panel. The dispute was settled when China withdrew the measures in question.³⁷ In 2008, in China-Measures Affecting Imports of Automobile Parts, a WTO Panel considered whether measures applied by China imposing a higher customs duty on parts imports if automobile manufacturers did not meet domestic content requirements were inconsistent with the prohibition on the use of domestic over imported goods provision in the SCM Agreement.³⁸ The Panel found other violations in the case and in the interests of “judicial economy” did not decide the domestic content issue.

Expedited dispute settlement. The SCM Agreement contains special, expedited dispute settlement rules and procedures pertaining to prohibited subsidy allegations. In contrast to normal WTO Dispute Settlement Understanding (DSU) procedures, there are no “standing” requirements other than for a Member “to believe that a prohibited subsidy is

³³ Although the Illustrative List does not refer to the OECD Arrangement as such, a number of WTO disputes have established that this is the only “international undertaking” with the characteristics referred to in the Illustrative List.

³⁴ Subsequent proceedings pursuant to Article 2.15 of the DSU found that Brazil’s revised PROEX payments did not constitute a prohibited subsidy.

³⁵ SCM Agreement, Article 3(b).

³⁶ WT/DS358/13 (13 July 2007).

³⁷ WT/DS358/14 (4 January 2008).

³⁸ WT/DS/339/R, WT/DS/340/R, WT/DS/342/R (July 18, 2008).

being granted or maintained.”³⁹ In addition, unless otherwise prescribed, the time periods applicable for the conduct of disputes are half the time normally prescribed under the DSU.⁴⁰ In the event of a complaint, consultations between the parties must take place as quickly as possible⁴¹ and if no solution has been reached within 30 days the matter may be referred to the Dispute Settlement Body (DSB) for the immediate establishment of a panel.⁴² The panel’s report must be circulated within 90 days of the date of its composition.⁴³ “If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay.”⁴⁴ In the event that the recommendation of the DSB is not followed within the specified time period, “the DSB shall grant authorization to the complaining Member to take appropriate countermeasures, unless the DSB decides by consensus to reject the request.”⁴⁵

Under the WTO Agreement on Agriculture, certain export subsidies were exempt from the provisions of the SCM Agreement, Articles 3, 5 and 6, for 9 years, counted from January 1, 1995.⁴⁶ These, and all other agricultural export subsidies, are now fully subject to the SCM Agreement.

Actionable subsidies and their remedies. Actionable subsidies may be challenged either through the DSU or through unilateral countervailing proceedings if they cause adverse effects to other Members. There are three types of adverse effects: (1) injury to a domestic industry manufacturing like products that occurs in the territory of the complaining Member; (2) “serious prejudice” such as export displacement in a third country market; and (3) “nullification or impairment” of benefits accruing under GATT, such as when improved market access from a bound tariff reduction is counteracted by subsidization. A challenge through the DSU can be based on any of these types of adverse effects while countervailing measures can only be based on the first type, injury to a domestic industry.

Countervailing measures. A Member may not impose a countervailing measure (e.g., a countervailing duty on imports) without first making three factual determinations: (1) the existence of subsidized imports; (2) injury to a domestic industry producing like products; and (3) a causal link between the subsidized imports and the injury. The effects of subsidized imports from more than one Member may be cumulated. Articles 10-23 of the SCM Agreement establish procedures for conducting investigations and imposing countervailing measures. Of significance to developing countries, countervailing investigations of imports from developing country Members are to be terminated if the overall level of subsidies granted does not exceed 2 percent of the product’s value on a

³⁹ SCM Agreement, Article 4.1.

⁴⁰ Ibid, Article 4.12.

⁴¹ Ibid, Article 4.3.

⁴² Ibid, Article 4.4.

⁴³ Ibid, Article 4.6.

⁴⁴ Ibid, Article 4.7.

⁴⁵ Ibid, Article 4.10. A footnote to this provision states that countermeasures that are disproportionate are not permitted.

⁴⁶ Agreement on Agriculture, Articles 1(f) and 13(c).

per unit basis or the volume of subsidized imports represents less than 4 percent of the total imports of the like product (unless subsidized imports from two or more developing country Members with individual market shares less than 4 percent collectively amount to more than 9 percent of total imports).⁴⁷

Notifications. The SCM Agreement imposes extensive notification requirements regarding specific subsidies and countervailing duty measures. The Agreement requires that members notify all specific subsidies to the SCM Committee by 30 June of each year with sufficient detail to allow other Members to evaluate the trade effects and understand the operation of the notified programs (Article 25.1 and 25.2)⁴⁸. “Members recognize that notification of a measure does not prejudice either its legal status, the effects under this Agreement, or the nature of the measure itself” (Article 25.7). If Members believe there are no measures that require notification, they must inform the WTO Secretariat in writing (Article 25.6).

2.2 Special and differential treatment for developing country Members

Special and differential treatment (SDT) is intended to improve market access for developing countries and to give them more flexibility regarding trade-related measures by exempting them from certain multilateral disciplines.⁴⁹ In general, the Uruguay Round reduced most SDT treatment for developing countries to extended transition periods to implement new disciplines.⁵⁰ The SCM Agreement, Article 27, is an example. Article 27 includes both exemptions from the prohibition on export subsidies for certain low-income countries and phase-in periods for middle-income countries. A phase-in period, now expired, was also included for the prohibition on the use of domestic over imported goods. Article 29, now also expired, provided for a 7 year phase-out period for prohibited subsidies for centrally-planned economies transitioning to market economies.

In addition to Articles 27 and 29 of the SCM Agreement, three other SDT provisions may apply to government incentives offered by developing countries in connection with SEZs. These are (1) GATT Article XVIII, Government Assistance to Economic Development; (2) Part IV of GATT, Trade and Development; and (3) the “Enabling Clause”. These are reviewed in Box 1. It is likely, however, that these other SDT provisions would be interpreted as not providing additional SDT exemptions beyond those provided in Article 27.

⁴⁷ SCM Agreement, Article 27.10.

⁴⁸ The WTO Committee on Subsidies and Countervailing Measures requires that Members provide new and full notifications every two years and conduct reviews of these notifications in the alternate years.

⁴⁹ See generally, T. Ademola Oyejide, *Special and Differential Treatment, Development, Trade, and the WTO: a Handbook* (ed. Hoekman, Mattoo and English, World Bank 2002). For an overview of the WTO’s SDT provisions, see *Implementation of Special and Differential Treatment Provisions in WTO Agreements and Decisions*, WT/COMTD/W/77 (25 October 2000).

⁵⁰ *Ibid*, p.507.

**Box 1: Special and differential treatment in addition to
the SCM Agreement Articles 27 and 29**

GATT Article XVIII

GATT Article XVIII was the original privilege accorded to developing countries. It permits deviation from the requirements of GATT, excepting Article I (MFN treatment), Article II (schedules of concessions) and Article XIII (non-discriminatory administration of quantitative restrictions). Under Section D, a country that is in the process of development but is not a low income country and that seeks to establish a particular industry may request approval of the proposed measure. The Doha Ministerial reaffirmed the application of XVIII to developing countries. WT/MIN(01)/17 (20 November 2001). However, since the SCM Agreement, Article 27, is a later specific interpretation of WTO disciplines, it is doubtful that the WTO would interpret GATT Article XVIII as providing a separate and additional SDT exemption for government subsidies.

GATT, Part IV (Articles XXXVI-XXXVIII)

GATT Article XXXVI states in pertinent part that “*There is need for a rapid and sustained expansion of the export earnings of the less-developed contracting parties.*” XXXVI.2. “*The developed contracting parties do not expect reciprocity for commitments made to them in trade negotiations to reduce or remove tariffs and other barriers to trade of less-developed contracting parties*” XXXVI.8. In the past developing countries have relied on these principles in applications for waivers of WTO/GATT commitments. However, since the SCM Agreement is a later specific interpretation of WTO disciplines it is doubtful that the WTO would interpret GATT, Part IV as providing a separate and additional SDT exemption for government subsidies.

The “Enabling Clause”

The “Enabling Clause”⁵¹ provides in pertinent part that “*Differential and more favourable treatment with respect to the provisions of the General Agreement concerning non-tariff measures governed by the provisions of instruments multilateral negotiated under the auspices of the GATT*” may be accorded to developing countries. Its application to LDCs in addition to Uruguay Round instruments was reaffirmed in the Uruguay Round Agreement.⁵² However, since the SCM Agreement is a later specific interpretation of WTO disciplines it is doubtful that the WTO would interpret the Enabling Clause as providing a separate and additional SDT exemption for government subsidies.

⁵¹ GATT Contracting Parties, Decision of November 28, 1979 on Differential and More Favourable Treatment, Reciprocity and Fuller Participation on Developing Countries, GATT B.I.S.D. (26th Supp.) at 203 (1980).

⁵² See Decision on Measures in Favour of Least-Developed Countries, Uruguay Round.

Article 27 of the SCM Agreement. Developing country Members that utilize export subsidies are accorded special and differential treatment (SDT) in the SCM Agreement in several ways, based upon their level of development:

- Least developed countries (LDCs) are excluded from the prohibition on export subsidies.
- Certain countries named in Annex VII(b) to the SCM Agreement are excluded from the prohibition on export subsidies until their GNP per capita exceeds USD \$1,000 in 1990 dollars for 3 consecutive years, subject to certain “graduation” and “re-inclusion” provisions.⁵³
- A number of other developing countries are not subject to the prohibition on export subsidies for certain identified programs, subject to notification, “standstill” and prior approval requirements. These extensions currently continue through 2015.⁵⁴

These exceptions are discussed in more detail below.

Annex VII(a) Members. Least developed country members of the WTO are exempted from the prohibition on export subsidies. Article 27.2 of the SCM Agreement provides that “*The prohibition of paragraph 1(a) of Article 3 shall not apply to (a) developing country Members referred to in Annex VII.*” (Article 3.1(a) is the prohibition on export subsidies.) Annex VII (a) references “*Least-developed countries designated as such by the United Nations which are Members of the WTO.*” The United Nations currently lists 50 nations as LDCs;⁵⁵ 33 of these are WTO members. Of the remaining 17, 12 are in various stages of the WTO accession process. See Table 1.

LDC Members that reach export competitiveness in any given product must gradually phase out export subsidies over a period of 8 years for that product.⁵⁶ LDCs are not exempted from the prohibition on subsidies contingent upon the use of domestic over imported goods imposed by SCM Agreement Article 3.1(b) and 3.2. This exemption expired at the end of 2003. See SCM Agreement Article 27.3.

⁵³ WT/MIN(01)/17, para. 10.1.

⁵⁴ See General Council decision of 31 July 2007, WT/L/691.

⁵⁵ <http://www.un.org/special-rep/ohrrls/ldc/list.htm>

⁵⁶ See SCM Agreement Article 27.5, 27.6, WT/MIN(01)/17, para 10.5. Pursuant to Article 27.6 of the SCM Agreement, export competitiveness exists if exports of a product have reached a share of at least 3.25% in world trade for that product for two consecutive calendar years. It should be noted, however, that there is considerable uncertainty over the correct legal interpretation of the definition of a “product” in this context because of an apparent conflict in the three official texts of the SCM Agreement. In the English version of Article 27.6, a “product” is defined as a “section heading” of the Harmonized System Nomenclature, although the Harmonized System itself contains “headings” (4-digit tariff lines), and “sections” (groups of chapters). The Spanish and French versions refer respectively to “partidas” and “positions”, both corresponding to the 4-digit HS level. The issue has been discussed in the SCM Committee, but no consensus view has emerged. It is much more likely that a given developing Member would reach export competitiveness in a product if a product is defined at the 4-digit HS level than if it is defined at the broader section level.

Table 1:
Countries exempted from the prohibition of export subsidies in the
WTO Agreement on Subsidies and Countervailing Measures

Least developed country WTO Members (SCM Art. 27.2(a) and Annex VII(a))	Members with a per capita GNP<\$1,000** (SCM Art. 27.2(a) and Annex VII(b))
Angola	Bolivia
Bangladesh	Cameroon
Benin	Congo
Burkina Faso	Cote d'Ivoire
Burundi	Egypt
Cambodia	Ghana
Cape Verde	Guyana
Central African Republic	Honduras
Chad	India
Democratic Republic of the Congo	Indonesia
Djibouti	Kenya
Gambia	Nicaragua
Guinea	Nigeria
Guinea-Bissau	Pakistan
Haiti	Philippines
Lesotho	Senegal
Madagascar	Sri Lanka
Malawi	Zimbabwe
Maldives	
Mali	
Mauritania	
Mozambique	
Myanmar	
Nepal	
Niger	
Rwanda	
Senegal	
Sierra Leone	
Solomon Islands	
Togo	
Uganda	
United Republic of Tanzania	
Zambia	

*) As of 28 July 2008. In addition, 12 LDCs are in the process of WTO accession: Afghanistan, Bhutan, Comoros, Equatorial Guinea, Ethiopia, Lao People's Democratic Republic, Liberia, Samoa, Sao Tome and Principe, Sudan, Vanuatu, Yemen. **) In 1990-US Dollars.

Source: World Trade Organization website, World Trade Organization, Document G/SCM/110/Add.4 (21 December 2007).

Annex VII(b) Members In addition to LDCs, Article 27.2(a) and Annex VII(b) name 20 WTO Members which are not subject to the prohibition on export subsidies until “GNP per capita has reached \$1,000 per annum: Bolivia, Cameroon, Congo, Cote d’Ivoire, Dominican Republic, Egypt, Ghana, Guatemala, Guyana, India, Indonesia, Kenya, Morocco, Nicaragua, Nigeria, Pakistan, Philippines, Senegal, Sri Lanka and Zimbabwe.” Honduras, which had been erroneously omitted from the original list, was subsequently added on January 20, 2001.

When the SCM Agreement went into effect in 1995, the interpretation of the SCM Committee was that the \$1,000 threshold reflected current US dollars. However, this interpretation meant that Members could graduate based upon inflation and changes in exchange rates rather than on real economic growth. As a consequence, at the Doha Ministerial in 2001 the WTO adopted an alternative approach, calculating the \$1,000 threshold in constant 1990 US dollars, which must be reached for three consecutive years.⁵⁷ It was also agreed that Members that graduate will be re-included in the list if their “GNP per capita falls back below US \$1,000.”⁵⁸ The most recent threshold calculation by the Committee was released in December 2007.⁵⁹ Based upon this calculation, the Dominican Republic, Guatemala and Morocco have graduated and the other 18 countries listed remain exempted from the export subsidy prohibition. See Table 1.

Annex VII(b) Members that reach export competitiveness in any given product must gradually phase out export subsidies for that product over a period of 8 years.⁶⁰ This may be of particular significance to Annex VII(b) countries with large, growing export-oriented economies, such as India, Indonesia, the Philippines, Egypt, and Pakistan. Annex VII(b) Members are not exempted from the prohibition on subsidies contingent upon the use of domestic over imported goods imposed by SCM Agreement Article 3.1(b) and 3.2. This exemption expired after five years – on December 31, 2000 – for non-LDCs. See SCM Agreement Article 27.3.

Article 27.4 Members. Developing countries other than Annex VII countries (including those that have graduated from Annex VII(b)) were required by the SCM Agreement, Article 27.4, to phase out their export subsidies within an eight year period (i.e., by December 31, 2002). However, a mechanism for an extension beyond that date was provided by Article 27.4, based upon a timely application to and agreement by the SCM Committee.

In 2001, a special procedure was implemented to meet the needs of certain small developing countries.⁶¹ Programs eligible for extensions were export subsidy programs as follows:

⁵⁷ WT/MIN(01)/17 (20 November 2001), para. 10.1. As of 1 January 2003 the calculation methodology in G/SCM/38, Appendix 2 applies. G/SCM/110/Add.4 (21 December 2007).

⁵⁸ Ibid, para. 10.4.

⁵⁹ G/SCM/110/Add.4 (21 December 2007).

⁶⁰ See SCM Agreement Article 27.5, 27.6, WT/MIN(01)/17, para 10.5.

⁶¹ See Implementation-Related Issues and Concerns, WT/MIN(01)/17 (20 November 2001), para 10.6; G/SCM/39 (20 November 2001). The special procedure was used to grant extensions over a period of five

- (i) in the form of full or partial exemptions from import duties and internal taxes
- (ii) which came into existence not later than 1 September 2001, and
- (iii) which were provided by developing country Members
- (iv) whose share of world merchandise export trade was not greater than 0.1%
- (v) whose total Gross National Income (“GNI”) for the year 2000 as published by the World Bank was at or below US \$20 billion
- (vi) and that were otherwise eligible to request an extension pursuant to Article 27.4, and
- (vii) that followed the procedures prescribed by the SCM Committee in WTO document G/SCM/39.

Members that met all the qualifications were eligible for a 5-year extension of the transition period (i.e., to December 31, 2007) plus the additional 2 year phase-out period provided for in Article 27.4 (i.e., to December 31, 2009). In July 2007, the WTO General Council approved an extension of these procedures through 31 December 2013, with the final two-year phase-out period ending not later than 31 December 2015.⁶² Under the July 2007 decision continuing the procedures, the Members receiving the extensions agreed not to seek any further extensions past the end of 2015 and to eliminate their export subsidies no later than that date.

The developing countries currently receiving extensions of the transition period for certain such programs are Barbados, Belize, Costa Rica, Dominica, Dominican Republic, El Salvador, Fiji, Guatemala, Jamaica, Jordan, Mauritius, Panama, Papua New Guinea, St. Lucia, St. Kitts and Nevis, and Uruguay.⁶³ Three additional Members that had not provided documentation supporting an extension, Antigua & Barbuda, Grenada and St. Vincent & the Grenadines, were given additional time by the Committee to submit documentation. In addition, certain Annex VII countries reserved their rights to invoke the same procedures in the event that they subsequently “graduated” from the Annex VII(b) exemption. See Table 2.

In a number of cases, the incentive programs notified related to Special Economic Zone measures. Antigua and Barbuda notified its “Free Trade/Processing Zones” program. Belize notified its “Export Processing Zone Act and Commercial Free Zone Act.” Costa Rica notified its “Duty Free Zone regime”. The Dominican Republic notified “Law No. 8-90, to Promote the Establishment of Free Trade Zones.” Fiji notified its “Export Processing Factories/Zones Scheme.” Guatemala notified “Free Zones” and “Industrial and Free Trade Zones (ZOLIC)”. Jamaica notified its “Jamaica Export Free Zone Act.” Mauritius notified its “Freeport Scheme.” Panama notified its “Export Processing Zone”. And St. Lucia notified its “Free Zone Act.”

years to certain Members for certain programs. In addition, four Members obtained one-year extensions for certain of their programs pursuant to Article 27.4 alone (i.e., not on the basis of the special procedure). These Members were Barbados, El Salvador, Panama, and Thailand. See, G/SCM/95-98; G/SCM/99; G/SCM/100; and G/SCM/101 Suppls. 1 and 2, and G/SCM/102.

⁶² WT/L/691 (31 July 2007).

⁶³ Report (2007) of the Committee on Subsidies and Countervailing Measures, G/L/840 (12 November 2007).

Table 2: Countries with a Further Extension of the Transition Period for Export Subsidies (SCM Art. 27.4)		
WTO Member	Notified Programs (bolded if concerning SEZs)	WTO Action
Antigua & Barbuda	Free Trade/Processing Zones. Fiscal Incentives Act	Extensions granted
Barbados	Fiscal Incentive Program. Export Allowance. Research & Development Allowance. International Business Incentives. Societies with Restricted Liability. Export Re-discount Facility. Export Credit Insurance Scheme. Export Finance Guarantee Scheme. Export Grant & Incentive Scheme.	Extensions granted
Belize	Export Processing Zone Act. Commercial Free Zone Act. Fiscal Incentives Program. Conditional Duty Exemption Facility.	Extensions granted
Bolivia (Annex VII(b))	Free Zone. Temporary Admission Regime for Inward Processing.	Reservation of rights
Costa Rica	Duty Free Zone Regime. Inward Processing Regime. Fiscal Incentives Program.	Extension granted
Dominica	Fiscal Incentives Program.	Extension granted
Dominican Republic	Law to Promote the Establishment of Free Trade Zones.	Extension granted
El Salvador	Export Processing Zones & Marketing Act.	Extension granted
Fiji	Export Processing Factories/Zones Scheme. Short-Term Export Profit Deduction.	Extension granted
Grenada	Fiscal Incentives Act. Qualified Enterprise Act. Statutory Rules and Orders.	Extension granted
Guatemala	Free Zones. Industrial and Free Trade Zones (ZOLIC). Special Customs Regimes.	Extension granted
Honduras (Annex VII(b))	Free Trade Zone of Puerto Cortes. Export Processing Zones. Temporary Import Regime.	Reservation of rights
Jamaica	Export Free Zone Act. Export Industry Encouragement Act. Foreign Sales Corporation Act. Industrial Incentives Act.	Extension granted
Jordan	Income Tax Law of 1985, amended.	Extension granted
Kenya (Annex VII(b))	Export Processing Zones. Export Promotion Program. Customs & Excise Regulation.	Reservation of rights
Mauritius	Freeport Scheme. Export Enterprise Scheme. Pioneer Status Enterprise Scheme. Export Promotion.	Extension granted
Panama	Export Processing Zones. Official Industry Register.	Extension granted
Papua New Guinea	Income Tax Act	Extension granted
Sri Lanka (Annex VII(b))	Income Tax Concessions. Tax Holidays & Profits Generated. Concessionary Tax on Dividends. Indirect Tax Concessions-Internal Tax Exemptions. Export Development Investment Support Scheme. Import Duty Exemption. Exemption from Exchange Control.	Reservation of rights
St. Kitts & Nevis	Fiscal Incentives Act.	Extension granted
St. Lucia	Free Zone Act. Fiscal Incentives Act. Micro & Small Scale Business Enterprise Act.	Extension granted
St. Vincent and the Grenadines	Fiscal Incentives Act	Extension granted
Uruguay	Automotive Industry Export Promotion Regime.	Extension granted

Sources: Subsidies Enforcement Annual Report to the US Congress (February 2008); WTO notifications.

The notification of SEZ programs pursuant to Article 27.4 to the SCM Committee does not constitute an admission that these programs are in fact prohibited subsidies. As noted previously, SCMA Article 25.7 provides that “*Members recognize that notification of a measure does not prejudice either its legal status ..., the effects under this Agreement, or the nature of the measure itself.*” (emphasis added) The most common SEZ incentive – the exemption of exported products from import duties or taxes assessed on like products shipped from the SEZ for domestic consumption – is excluded from the definition of subsidy. However, corporate tax holidays and similar incentives may be prohibited subsidies if they are contingent in law or fact on export performance. Notably, the existence of export requirements, or restrictions on selling products from the SEZ into the domestic market, would constitute such a contingency on export performance.

Article 27.4 countries must phase out export subsidies for products that have reached “export competitiveness” over a period of two years.⁶⁴ Export competitiveness exists if exports of the product have reached a share of at least 3.25% in world trade for that product for two consecutive calendar years.⁶⁵ It seems unlikely that the small economies that qualify under Article 27.4 will reach this level of world trade for any exports. Article 27.4 countries are not exempted from the prohibition on subsidies contingent upon the use of domestic over imported goods imposed by SCM Agreement Article 3.1(b) and 3.2. This exemption expired after 5 years. See SCM Agreement Article 27.3.

Transformation to a Market Economy. Article 29 of the SCM Agreement provides special transition rules for Members in the process of transforming from a centrally-planned economy to a market economy. Subsidy programs that are covered by Article 3 were required to be phased out by December 31, 2002. In “exceptional circumstances” additional time could have been granted⁶⁶, but no requests for such extensions were received.

Recent Accessions. A number of non-LDC developing countries, some with a per capital GNP of less than \$1,000 in 1990 dollars, have acceded to the WTO during the 12 years since the WTO came into existence. These include Albania (2000), Armenia (2003), China (2001), Georgia (2000), Kyrgyz Republic (1998), FYR of Macedonia (2003), Moldova (2001), Mongolia (1997), Tonga (2007), Ukraine (2008), and Vietnam (2007). Almost all of these recent accessions are countries in the process of transforming from a centrally-planned economy to a market economy. However, these new Members were generally required to eliminate all prohibited subsidies as a condition of accession.⁶⁷

Doha Development Round Negotiations. As a part of the DDR negotiations, the WTO Rules Negotiating Group is currently considering various proposals to revise the SCM

⁶⁴ Article 27.5.

⁶⁵ Article 27.6.

⁶⁶ Article 29.4.

⁶⁷ See, e.g., Report of the Working Party on the Accession of China, WT/ACC/CHN/49 (1 October 2001), p. 33; Report of the Working Party on the Accession of the FYR of Macedonia, WT/ACC/807/27 (26 September 2002), p. 24; Report of the Working Party on the Accession of Ukraine, WT/ACC/UKR/152 (25 January 2008) pp. 63-64; Report of the Working Party on the Accession of Vietnam, WT/ACC/VNM/48 (27 October 2006), pp. 72, 92, 93.

Agreement. Some developed country Members have proposed expansion of the category of prohibited subsidies.⁶⁸ In November 2007, the Chairman circulated a proposed text⁶⁹ and this became the focus of intensified negotiations. It is not possible to predict what changes to existing subsidy disciplines, if any, may result from these negotiations.

3. Other WTO Provisions of Relevance for SEZs

3.1 Most favored nation treatment; GATT Article I

A cornerstone of the WTO system is the most favored nation (MFN) principle. It is a legal requirement to accord equal treatment to all Member nations regarding covered trade measures. (WTO approved regional trade agreements are an exception. See GATT Article XXIV.) The MFN principle applies to trade in goods (GATT Article I), trade in services (GATS Article II) and the protection of intellectual property rights (TRIPS Article 4). The denial of MFN treatment has been an issue in a number of WTO disputes. See, e.g., EC – Bananas III, DS27 (1997) (export certificate requirements accorded an advantage to some Members only); Indonesia-Autos, DS54, DS55, DS59, DS64 (1998) (duty and sales exemptions accorded to Korean auto imports were not accorded unconditionally to like products from other Members).

The MFN principle might be contravened if a government imposes measures that discriminate in law or fact between goods (or services) based upon the country of origin.

3.2 National treatment; GATT Article III

A second cornerstone of the WTO system is the national treatment principle. National treatment imposes an obligation of non-discrimination between domestic and imported goods. It is a principle incorporated in GATT, Article III and GATS, Article XVII. The denial of national treatment has been a frequent issue in WTO disputes. See, e.g., Japan-Alcoholic Beverages II, DS8, DS10, DS 11 (1996)(Japan taxed *shochu* – an indigenous alcohol – at a lower rate than imported alcoholic beverages); Indonesia-Autos, DS54, DS55, DS59, DS64 (1998)(Indonesian cars taxed at a lower rate than imported cars). Prohibited subsidies involving the purchase of domestic over imported goods also may contravene GATT Article III. See, e.g., China-Certain Measures Granting Refunds, Reductions or Exemptions from Taxes and Other Payments, WT/DS/358/13 (2007). The Agreement on Trade-Related Investment Measures, discussed below, also prohibits measures inconsistent with national treatment.

The national treatment principle might be contravened if a government imposes measures that discriminate in favor of domestic over foreign goods or services.

⁶⁸ See Subsidies Enforcement Annual Report to the Congress, Joint Report of the Office of the United States Trade Representative and the U.S. Department of Commerce, February 2008.

⁶⁹ See TN/RL/W/213.

3.3 Fees and formalities; GATT Article VIII(I)

GATT Article VIII(1)(a) provides that fees and charges of whatever character (other than duties and taxes) connected with importation and exportation must be limited to the approximate cost of services rendered. This principle would be contravened if a government imposed fees that exceeded the fully allocated cost of the services rendered. See, e.g., Argentina-Textiles and Apparel, DS56 (1998)(statistical tax on imports exceeded the approximate cost of the services rendered and was a measure designed for fiscal purposes).

The “fees limited to the approximate cost of the services rendered principle” might be contravened if a government imposes fees on the processing of imports and exports in excess of the approximate cost of the services rendered.

3.4 Transparency; GATT Article X

GATT Article X imposes various requirements including the publication and administration of trade regulations. Laws, regulations, judicial decisions and administrative rulings relating to import and export matters, duty and tax rates and other charges, or “their sale, distribution, transportation, insurance, warehousing, inspection, exhibition, processing, mixing or other use” must be published promptly to enable governments and traders to become acquainted with them. Article X(1). The failure to publish violates this requirement. See, e.g., Dominican Republic-Import and Sale of Cigarettes, DS302 (2005)(selective consumption tax contrary to GATT Article X(1)).

The “transparency” requirement might be contravened if a government imposes generally applicable trade requirements that have not been published.

3.5 Elimination of quantitative restrictions; GATT Article XI

GATT Article XI prohibits quotas, import and export licenses, and other measures (excepting duties, taxes and other charges) that prohibit or restrict trade. This broad prohibition applies to restrictions on the importation or exportation of goods. For example, in India-Quantitative Restrictions, DS90 (1999), the Panel found that India’s discretionary import licensing system and other measures amounted to quantitative restrictions inconsistent with GATT Article XI(1). Similarly, in Turkey-Textiles, DS34 (1999), quantitative restrictions on textile imports from India were found to be inconsistent with GATT Articles XI and XIII.

There are three exceptions in Article XI to the prohibition on quantitative restrictions. First, Members may apply restrictions temporarily to prevent or relieve critical shortages of food or other essential products. Second, Members may apply restrictions necessary to the application of standards or regulations for the classification, grading or marketing of commodities in international trade. Third, Members may apply restrictions on agricultural

or fisheries products necessary to enforce government support programs. In addition, exceptions to Article XI are contained in GATT Article XII (restrictions to safeguard balance of payments), Article XX (general exceptions), Article XXI (security exceptions), and the Agreement on Safeguards. The Agreement on Import Licensing Procedures regulates the administration of import quotas.

The Agreement on Trade-Related Investment Measures, discussed below, also prohibits quantitative restrictions inconsistent with Article XI.

The quantitative restrictions prohibition might be contravened if a government implements measures that prohibit or restrict certain imports or exports and those restrictions are not justified by applicable WTO exceptions.

3.6 Agreement on Trade-Related Investment Measures (TRIMs)

TRIMs “applies to governmental investment measures related to the trade in goods only.”⁷⁰ TRIMs clarifies the application of GATT Article III regarding national treatment and GATT Article XI regarding quantitative restrictions.⁷¹ Article 2 of TRIMs prohibits trade-related investment measures inconsistent with GATT Article III (national treatment) and XI (quantitative restrictions). The Annex lists 5 TRIMs that are inconsistent with national treatment and the elimination of quantitative restrictions. TRIMs inconsistent with national treatment include governmental measures regarding:

- purchase or use by an enterprise of products of domestic origin or any domestic source, whether specified in terms of product identity, volume or value of products, or a proportion of volume or value of its local production (local content requirements)
- limitation of an enterprise’s purchase or use of imported products to an amount related to the volume or value of the local products that it exports (trade balancing requirements)

TRIMs inconsistent with the elimination of quantitative restrictions include governmental measures regarding:

- importation by an enterprise of products used in or related to its local production in an amount related to the volume or value of local production it exports (trade balancing requirements)
- importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise (foreign exchange restrictions)

⁷⁰ TRIMs, Article 1.

⁷¹ See Bijit Bora, Trade-Related Investment Measures, in Bernard Hoekman, Aaditya Mattoo, Philip English, Development, Trade, and the WTO (World Bank 2002).

- exportation or sale for export by an enterprise of products, whether specified by particular products, in terms of volume or value, or in terms of proportion of volume or value of its local production

Article 4 provides that developing country Members are free to deviate temporarily from the provisions of Article 2 (the requirement to accord national treatment and the prohibition on quantitative restrictions) as may be permitted by GATT Article XVIII (the infant industry provision), and for balance of payments purposes. In addition, Article 5.3 provides for extensions regarding the elimination of TRIMs for developing and LDC members. SDT treatment proposals are currently under consideration by the TRIMs Committee.⁷²

TRIMs might be contravened if a government imposes investment measures that discriminate in favor of domestic over foreign goods and/or impose quantitative restrictions related to local production.

3.7 General Agreement on Trade in Services (GATS)

GATS applies to government measures affecting trade in services.⁷³ It covers all services except for those provided by government.⁷⁴ An understanding of GATS is important in any assessment of WTO disciplines applicable to SEZs because many SEZs host various service providers (telecommunications, banks, insurance companies and other financial services, brokers, freight forwarders and providers of other trade support, etc.).

At the core of GATS are national treatment and MFN provisions. However, both national treatment and most favored nation treatment are highly qualified. National treatment is extended by GATS Article XVII only to service sectors listed in individual Member's schedules of specific commitments and even these commitments may be conditioned and qualified. Members can list exemptions to MFN treatment in Article II in the Annex on Article II Exemptions.

In those service sectors liberalized pursuant to a Member's schedule, six measures are prohibited by Article XVI(2). These are, in summary: (1) limitations on the number of service suppliers; (2) limitations on the value of transactions or assets; (3) limitations on the total number of service operations or total quantity of service output; (4) limitations on the number of natural persons that can be employed in a particular service sector; (5) limitations on the type of legal entity that can be used; and (6) limitations on participation of foreign capital and investment.

⁷² G/L/837 (9 November 2007).

⁷³ GATS, Article 1.

⁷⁴ There are four modes of trade in services covered: cross-border trade (mode 1); consumption abroad (mode 2); commercial presence (mode 3); and presence of natural persons (mode 4). Ibid.

Government subsidies to service providers are not currently included as a measure subject to GATS discipline.⁷⁵ Article XV recognizes that subsidies may adversely affect trade in services and commits Members to negotiate in the future to develop disciplines regarding service subsidies.

Depending on an individual Member's schedules of specific commitments, GATS might be contravened if a government measure confers preferential treatment to local service providers (denial of national treatment) or confers preferential treatment to service providers from certain foreign countries (denial of MFN treatment). In addition, in service sectors liberalized under a particular Member's schedule, the above-listed six measures in GATS Article XVI(2) are prohibited.

4. A Matrix of WTO Disciplines

The fiscal incentives offered by SEZs have become almost standardized internationally as a result of competitive pressures.⁷⁶ SEZ incentives include corporate tax reductions or exemptions for businesses that locate in SEZs; duty free and tax free importation of raw materials, intermediate inputs, capital goods and production equipment; no restrictions or taxes on capital and profits repatriation; exemption from foreign exchange controls when applicable; no duties or taxes assessed on exports; and exemption from most local and indirect taxes.⁷⁷ In addition, utilities may be provided at below-market rates and grants for education and training of workers may be provided.⁷⁸ However, “the reliance of zone programs on incentives ...(such as income tax holidays) imposes significant costs on government budgets with little benefit...”⁷⁹

Typical fiscal incentive and export promotion measures offered in connection with SEZ programs are analyzed below. For convenience, measures are divided into WTO consistent measures (“green light measures”), WTO prohibited measures (“red light measures”), and WTO questionable measures (“amber light measures”).⁸⁰

⁷⁵ The SCM Agreement, Annex I(h) covers the exemption, remission or deferral of prior-stage cumulative indirect taxes on services used in the production of export products in excess of the exemption, remission or deferral of taxes on services used in the production of goods for domestic consumption. This appears to be the only instance in which services are subject to a subsidies discipline.

⁷⁶ See Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development, *supra*, pp. 48-49.

⁷⁷ *Ibid*.

⁷⁸ Michael Engman, Osamu Onodera and Enrico Pinali, Export Processing Zones: Past and Future Role in Trade and Development (OECD Trade Policy Working Paper No. 53, TD/TC/WP(2006)39/FINAL, p. 17.

⁷⁹ Special Economic Zones: Performance, Lessons Learned, and Implications for Zone Development, *supra*, p. 49.

⁸⁰ The descriptions of measures, explanations and recommended actions have been summarized for easy reference. In some cases, this may have unintentionally resulted in the omission of important details. The references to specific measures prohibited in Annex I is not meant to imply that Annex I is anything other than an illustrative list of export subsidies; measures not listed in Annex I may also constitute export subsidies if they fit the definition in SCMA Article 3.1(a).

4.1 Typical SEZ measures that are WTO consistent (green light measures)

Measure	Explanation
Measures imposed by non-governmental organizations, including incentives to businesses locating in SEZs.	WTO disciplines do not apply to measures applied by private sector organizations, such as private SEZ operators, unless they are carrying out a governmental directive or the benefit is funded by government.
Exemption of exported products from import duties.	The exemption of products exported to other countries from an SEZ from duties is not a “subsidy”. SCM Agreement, footnote 1.
Exemption of exported products from indirect taxes.	The exemption of a product exported to other countries from an SEZ from indirect taxes is not a “subsidy”. SCM Agreement, footnote 1. (Indirect taxes are sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes, and all taxes other than direct taxes and import charges. SCM Agreement, footnote 58.)
Exemption of goods used in the production process from duties and indirect taxes when the end products are exported (as long as indirect tax exemption does not exceed that accorded to goods produced for domestic consumption).	The exemption of production goods incorporated in end products that are subsequently exported to other countries from duties and indirect taxes is based on SCM Agreement, footnote 1 and Annex 1(h).
Exemption of production waste from duties and indirect taxes when the waste is exported to other countries.	The exemption of production waste from duties and taxes when exported is based on SCM Agreement, footnote 1 and Annex 1(h). (Exported production waste is a “product”.) Production waste entered into the customs territory is subject to duty and taxes, depending on its value.
Exemption of goods stored in SEZs from duties and indirect taxes.	Zones outside the “customs territory” of the country where they are physically located are recognized by multilateral agreement (WCO Revised Kyoto Convention, Specific Annex D, chapter 2) and customary international law. Duties and indirect taxes are normally not applied in these “free areas”.
Non-specific subsidies, including generally applicable tax rates imposed by national, regional and local government authorities.	Subsidies are non-specific if they are based on objective criteria or conditions and eligibility is automatic. Nation-wide programs are non-specific. National programs limited to designated regions or a limited number of enterprises are specific. However, generally applicable tax rates are non-specific, irrespective of the tax rates imposed in other regions or localities of a country. SCM Agreement, Article 2.2. Example: An SEZ is an independent government taxing authority which imposes lower (or no) taxes compared with comparable regional or local governmental authorities in the same nation. This is not a “specific” subsidy. On the other hand, if a national government exempts a particular region from taxes, this is a “specific” subsidy.

4.2 Typical SEZ measures that are WTO illegal (red light measures)

Measure	Explanation	Remedy
Direct subsidy contingent on export performance (e.g., cash payments are given by government based upon export performance).	Prohibited by SCMA Article 3.1(a) and Annex I(a). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove cash payment or other direct subsidy <i>or</i> remove export performance requirement.
Currency retention schemes involving a bonus on exports (e.g., SEZ exporters are allowed to retain foreign currency based on export performance).	Prohibited by SCMA Article 3.1(a) and Annex I(b). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove bonus based on export performance.
Internal transport and freight charges more favorable for export shipments than for domestic shipments (if mandated by government).	Prohibited by SCMA Article 3.1(a) and Annex I(c). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove transport and freight preferences for export shipments.
Provision by government of domestic products or services for use in production of exported goods on terms more favorable than for production of domestic goods (if the terms are more favorable than those commercially available on world markets) (e.g., a government provides electricity and other utilities for businesses in an SEZ at lower rates than for businesses outside the SEZ, and limits or prohibits imports from the SEZ for domestic consumption (i.e., consumption in the non-SEZ portion of the Member's territory) and/or imposes export requirements).	Prohibited by SCMA Article 3.1(a) and Annex I(d). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove discount for goods or services used for production of exported goods <i>or</i> remove limits on imports from the SEZ for domestic consumption and remove export requirements.
Full or partial exemption, remission or deferral of direct taxes or social welfare charges imposed on businesses if contingent on exports (e.g., a government provides tax incentives to businesses in an SEZ and prohibits or limits imports from the SEZ for domestic consumption and/or imposes export requirements).	Prohibited by SCMA Article 3.1(a) and Annex I(e). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove exemptions from direct taxes or social welfare charges <i>or</i> remove restrictions on imports from the SEZ for domestic consumption. Remove export requirements.
Allowance of special direct tax deductions directly related to exports above those granted for domestic production (this applies Annex I(e) to tax deductions).	Prohibited by SCMA Article 3.1(a) and Annex I(f). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove deductions for direct taxes or social welfare charges <i>or</i> remove restrictions on imports from the SEZ for domestic consumption; remove export performance requirements.
Exemption or remission of indirect taxes on exports <u>in excess</u> of those levied on goods sold for domestic consumption (e.g., the VAT rate on a good sold for domestic consumption is 20%, while the exporter receives a VAT rebate of 25% when it exports the same product).	Prohibited by SCMA Article 3.1(a) and Annex I(g). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove indirect tax exemption or remission preference for exports.

Measure	Explanation	Remedy
Exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products <u>in excess</u> of products sold for domestic consumption (e.g., exemption from sales tax on transport charges for an intermediate component used in an SEZ manufacturing process for a final product that is exported, where no such exemption is given on the transport of the same kind of component to a domestic manufacturer not located in the SEZ). Note: this provision is not applicable to products consumed in the production of exported products, consistent with Annex II.	Prohibited by SCMA Article 3.1(a) and Annex I(h) and Annex II. Certain countries are exempt from this prohibition (see Tables 1 and 2).	Remove prior-stage cumulative indirect tax exemption preference for exports.
Provision by governments of export credit guarantee or insurance programs at premium rates inadequate to cover long-term costs.	Prohibited by SCMA Article 3.1(a) and Annex I(j). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Increase premium rates to a level adequate to cover long-term costs.
Government grants of export credits at rates below those which they pay for the funds, or at below market rates, or payment of all or part of the costs in obtaining credits. However, export credit practices in conformity with certain international agreements are exempt.	Prohibited by SCMA Article 3.1(a) and Annex I(k). Certain countries are exempt from this prohibition (see Tables 1 and 2).	Change export credit rates to rates at which the government obtains the funds (market rates) or rates consistent with relevant international agreements.
Legal provisions that allow output from the SEZs to be treated as “domestic production” based on local content or other criteria without application of national import duties and taxes when imported for domestic consumption.	Prohibited by SCMA Article 3.1(b). All exemptions have expired except for those negotiated in accessions. See Article 27.3.	Eliminate legal provisions that allow output from the SEZs to be treated as “domestic production” based on local content or other criteria and ensure that SEZ output sold in the non-SEZ portion of the WTO Member’s territory includes application of import duties and taxes.
Subsidy contingent on the use of domestic over imported goods.	Prohibited by SCMA Article 3.1(b) except for those negotiated for accessions. All exemptions have expired. See Article 27.3.	Remove requirement to use domestic goods.
Certain countries are accorded preferential treatment by government directive. Example: Duty and sales tax exemptions on goods exported from SEZ are only granted if the goods are exported to certain Members.	Prohibited by GATT Article I, unless preference is justified pursuant to a regional trade agreement (GATT Article 24). There are no exemptions for developing countries.	Remove illegal preference.
Domestic goods are given preference over foreign goods by government directive. Example: An SEZ is required by government to use domestic inputs when manufacturing goods for export.	Prohibited by GATT Article III. SCM Agreement, Article 3.1(b) prohibits subsidies contingent upon the use of domestic over imported goods. There are no exemptions.	Remove illegal preference or subsidy.

Measure	Explanation	Remedy
Fees or taxes on imports or exports exceed the cost of services provided by government. Example: A customs processing fee imposed by government in connection with SEZ operations exceeds the cost of the services rendered.	Prohibited by GATT Article VIII(1). Fees and charges must be limited to the approximate cost of services rendered. There are no exemptions for developing countries.	Adjust fees and charges to correspond to the approximate cost of the services rendered.
Import and export laws and regulations that are not published and made publicly available by Internet or otherwise. Example: An SEZ operates without published regulations and procedures.	Prohibited by GATT Article X. There are no exemptions for developing countries.	Publish all laws, regulations, directives and decisions relating to imports and exports.
Quotas and/or export or import licenses are used to restrict trade. Example: A government imposes a quota on the importation of electronic consumer products and requires import licenses as a condition of importation.	Prohibited by GATT Article XI unless subject to the three exceptions in Article XI and the exceptions in GATT XII (balance of payments), GATT XX (general exceptions) and GATT XXI (security exceptions), and the Agreement on Safeguards. Import licenses are subject to the provisions of the Agreement on Import Licenses. SDT treatment may be available in “exceptional circumstances” under GATT XXV and the Enabling Clause.	Eliminate illegal quota.
Government requires purchase or use of domestic products, whether specified in terms of volume, value of products or proportion of volume or value of local production.	Prohibited by TRIMs Annex 1(a). Also prohibited by GATT Article III	Eliminate requirement to purchase or use domestic products.
Government limits enterprise’s purchases or use of imported products to an amount related to the volume or value of the local products that it exports.	Prohibited by TRIMs Annex 1(b). Also prohibited by GATT Article III.	Eliminate domestic purchase or use requirement.
Government quantitative restrictions for which no exemption is applicable that restrict imports used in local production based upon the value of the local production that it exports.	Prohibited by TRIMs Annex 2(a) and GATT Article XI.	Eliminate quantitative restriction.
Government restrictions of imports by restriction access to foreign exchange to an amount related to foreign exchange inflows attributable to the enterprise.	Prohibited by TRIMs Annex 2(b) and GATT Article XI.	Eliminate restrictions on access to foreign exchange based on foreign exchange inflows attributable to enterprise.
Government restrictions on exports by an enterprise based upon the volume or value of its local production.	Prohibited by TRIMs Annex 2(c) and GATT Article XI.	Eliminate restrictions on exports based upon the volume or value of local production.

4.3 Typical SEZ measures that are WTO questionable (amber light measures)

Measure	Explanation	Proposed Action
Duty and tax free treatment of production equipment used in SEZs.	Goods stored in SEZs are duty and tax free. In addition, products that are exported or are used or consumed in the production process in SEZs are duty and tax free. Some commentators argue that capital goods used in the production process in SEZs are not covered by these exemptions. See Raul Torres, Free Zones and the World Trade Organization Agreement on Subsidies and Countervailing Measures, Global Trade and Customs Journal, vol. 2, issue 5 (2007), p. 221. Mr. Torres' view appears to reflect the views of the WTO SCM Committee staff. The counterarguments are that (1) all goods stored in SEZs are duty and tax free; (2) duty and tax exemptions for production equipment are not specifically listed as a prohibited subsidy in SCMA Annex I; and (3) at the end of its useful life in the SEZ production equipment will either be exported duty and tax free; entered into domestic commerce upon payment of applicable duties and taxes; or discarded as scrap. Duty and tax exemptions for production equipment are employed by many SEZ programs around the world.	The contractual arrangements regarding production equipment used in an SEZ may determine whether exemptions from duties and taxes for production equipment constitute a prohibited subsidy. For example, imported production equipment that is leased and that by contract will be exported at the end of the lease may be deemed a "product" exempt from duties and taxes pursuant to SCMA footnote 1. Production equipment that is purchased and installed as a permanent fixture in an SEZ may not be exempt because it is deemed to be capital equipment, not a "product". There is no clear precedent regarding this issue and SEZ programs that exempt production equipment from duties and taxes should be aware of the risk that the measure could be determined to be an export subsidy.
Government subsidies for infrastructure development in an SEZ (e.g., a government pays for roads, sewage systems, buildings, harbors, airports, electrical grids, water systems, etc.).	Government provision of "general infrastructure" falls outside the scope of the SCM Agreement (SCMA Article 1.1(a)(1)(iii)). However, Government assistance to a designated geographic region is considered to be a specific subsidy. SCMA Article 2.2. As a specific subsidy, it is "actionable" pursuant to SCMA Articles 5-7 or the provisions on countervailing measures. However, it is not a prohibited subsidy unless it is contingent on export performance or the use of domestic over imported goods. Article 3.1. A requirement that the SEZ export all or most of its production or a limitation on sales to the domestic market may turn government subsidies for SEZ development into a prohibited subsidy.	Infrastructure development subsidies should not be linked to requirements that an SEZ export all or most of its production. Infrastructure development subsidies that are specific to SEZs may be "actionable" but SDT provisions regarding countervailing measures make it unlikely that most countries will be subject to unilateral countervailing action resulting from infrastructure development subsidies.
Members whose export subsidies are exempted pursuant to SCMA Article 27.2(b) reach "export competitiveness" for a product pursuant to Article 27.5.	Certain countries are eligible for exemption from the prohibition on export subsidies through 2015. See Table 2. However, if they reach "export competitiveness" for a product (a share of at least 3.25% of world trade for two consecutive years) they must phase out export subsidies for that product within two years.	"Export competitiveness" for products should be monitored on the basis of Harmonized Tariff Schedules Nomenclature. Export subsidies for products that reach "export competitiveness should be eliminated within two years.

Measure	Explanation	Proposed Action
Members whose export subsidies are exempted pursuant to SCMA 27.2(a) and Annex VII(b) reach “export competitiveness” for a product pursuant to Article 27.5.	Certain low middle-income countries are exempted from the prohibition on export subsidies until per capita GNP exceeds \$1,000 in 1990 dollars for three consecutive years.	“Export competitiveness” for products should be monitored on the basis of Harmonized Tariff Nomenclature item numbers. Export subsidies for products that reach “export competitiveness should be eliminated within 8 years.
All countries’ export subsidies benefiting from SDT treatment (SCMA Article 27).	Export subsidies that are exempt from the prohibition on export subsidies pursuant to SCMA Article 27 are nonetheless specific subsidies and as such they are actionable pursuant to SCMA Article 27.7 and may also be countervailable. The United States Government has taken the position that export subsidies exempt pursuant to Article 27 are actionable.	SDT provisions regarding unilateral countervailing measures make it unlikely that most countries will be subject to countervailing action resulting from exempted export subsidies.
Government subsidies to SEZ businesses that export most of their production, with no <i>de jure</i> government requirement to export.	Article 3.1(a) and footnote 4 to the SCMA provide that an export subsidy exists “when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to” exports. In Australia-Automotive Leather II (DS126) (1999), the recipient was required to meet sales goals that exceeded the domestic market and 90% of the product was exported. The Panel found that payments under a grant contract were prohibited subsidies because payments were in fact tied to export performance.	A broad range of enterprises, including those making products primarily for the domestic market, should be encouraged to locate in SEZs. Every effort should be made to encourage the domestic consumption of products produced in SEZs.

5. Achieving WTO Compliance

There are four principal elements in a program to achieve WTO compliance regarding government measures employed in connection with SEZ programs. These are (1) a thorough review of all applicable measures and identification of possible inconsistent measures; (2) prompt reporting of possible WTO inconsistent measures; (3) development of a plan to phase-out WTO inconsistent measures; and (4) implementation of the phase-out plan. These are summarized below.

Review and Identification. All Members, and in particular middle income countries, should review their SEZ programs in detail to assure compliance with the SCM Agreement and other WTO disciplines. This is best accomplished using independent advisors and not government officials or local experts that may have a vested interest in defending the existing measures. It may be appropriate to request technical assistance from experts at the WTO, international financial institutions and other donors in connection with such a review. Upon request, the WTO Secretariat staff routinely provide confidential advice and in-depth technical assistance to individual Members about their programs, including bringing these into conformity with WTO disciplines.

SEZ programs in middle income countries are examined by the WTO as part of regularly scheduled trade policy reviews (TPRs). MICs are normally reviewed every 6 years. Preparation by MICs for scheduled TPRs should include a thorough review of all measures relating to SEZs.

Members that maintain export subsidies pursuant to SCM Agreement Article 27.2 (b) and Annex VII(b) (the per capita GNP under \$1,000 in 1990 dollars provision) should annually determine (a) whether per capita GNP has exceeded the limit for 3 consecutive years⁸¹, and (b) whether specific products have reached “export competitiveness” pursuant to SCMA Articles 27.5 and 27.6.⁸² Members that maintain export subsidies pursuant to Article 27.4 and relevant extensions should also monitor whether specific products have reached “export competitiveness” and comply with all reporting and notification requirements.

Notification. Changes with regards to export subsidy exemptions and other measures that are specific subsidies should be notified to the WTO Committee on Subsidies and Countervailing Measures by 30 June of each year.⁸³ The notifications must contain sufficient detail to enable an understanding of the operation of the subsidy programs and

⁸¹ See the calculations produced and circulated by the WTO Secretariat in the G/SCM/110/... series,

⁸² As discussed before, there is uncertainty over the breadth of the definition of a “product”. If the correct interpretation is that this is a 4-digit HS tariff heading, it is clearly far more likely that a given product will reach export competitiveness than if the correct interpretation is that this is an entire section of the HS. Members should monitor this assessment on both bases. In addition, the WTO Secretariat can be requested, pursuant to Article 27.6, to calculate whether a given developing Member has reached export competitiveness in a product. To date, such calculations have been requested and performed for Colombia, Thailand and India. See G/SCM/46, G/SCM/48, and G/SCM/103.

⁸³ SCMA Article 25.1.

an understanding of their trade effects.⁸⁴ Progress made in the removal of export subsidies and other subsidy measures should also be notified to the Committee. Countries entitled to a phase-out period for export subsidies pursuant to Article 27.4 and WTO decisions must also meet annual notification requirements regarding these subsidies.

Other WTO inconsistent measures should be notified to appropriate WTO bodies. See, e.g., GATS, Article III.3. WTO trade policy reviews assess whether reviewed Members have complied with notification requirements.

Compliance plan. The next step is the development of a compliance plan to change prohibited subsidies and other WTO prohibited measures into WTO non-prohibited measures or to remove the measure. In this connection, it is important to consult with SEZ businesses and investors. In some instances, SEZ incentive measures cannot be modified or repealed without the consent of existing businesses and investors that have made financial commitments in reliance on these incentives. For example, after SEZ incentive measures were repealed in Ukraine in 2005, subsequent court decisions continued the fiscal measures for certain investors.⁸⁵

In many instances, prohibited export subsidies can be converted into actionable subsidies by removing any de jure or de facto obligation to export goods produced in an SEZ and allowing zone enterprises full access to the domestic market on a duty and tax paid basis. In addition, specific but allowed subsidies can be converted into non-specific subsidies by, for example, extending benefits such as tax reductions to all businesses irrespective of location or sector. This would move them outside the scope of the SCMA's provisions.

Implementation. Members that do not have the benefit of SDT treatment for export subsidies should remove illegal export subsidies and other measures that are WTO inconsistent as soon as possible.

Currently, pursuant to SDT treatment, 18 countries can maintain export subsidies because their per capita GNP is under US\$1,000 in 1990 dollars (see Table 1) and 16 MICs can maintain "grandfathered" export subsidies through 2015 (see Table 2). Both categories of exempt countries should plan to phase-out all export subsidies by 2015 at the latest since it is well possible that the countries in the first category will "graduate" by then (i.e., per capita GNP will exceed \$1,000 in 1990 dollars for three consecutive years) and that further extensions will not be granted for "grandfathered" programs. In view of the likelihood that the legal rights of SEZ investors may prevent the termination of fiscal incentives without compensation, the phase-out of export subsidies should begin as soon as possible and not be deferred until near the end of the extension period.

Countries whose products are "graduated" pursuant to the provisions of SCMA Articles 27.5 and 27.6 should develop export subsidy elimination plans for those products so that the subsidy can be eliminated within the time periods required by the Agreement (8 years for an Annex VII Member, 2 years for other Members).

⁸⁴ Ibid, Article 25.3.

⁸⁵ Sergei Salivon, "They Will be There Forever," Tax News, BIZNES (October 1, 2007).

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Annex: Illustrative List of Export Subsidies (SCMA, Annex I)

Agreement on Subsidies and Countervailing Measures, Annex I

ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

- (a) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.
- (b) Currency retention schemes or any similar practices which involve a bonus on exports.
- (c) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.
- (d) The provision by governments or their agencies either directly or indirectly through government-mandated schemes, of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available⁸⁶ on world markets to their exporters.
- (e) The full or partial exemption remission, or deferral specifically related to exports, of direct taxes⁸⁷ or social welfare charges paid or payable by industrial or commercial enterprises.⁸⁸

⁸⁶ The term "commercially available" means that the choice between domestic and imported products is unrestricted and depends only on commercial considerations.

⁸⁷ For the purpose of this Agreement:

The term "direct taxes" shall mean taxes on wages, profits, interests, rents, royalties, and all other forms of income, and taxes on the ownership of real property;

The term "import charges" shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

The term "indirect taxes" shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

"Prior-stage" indirect taxes are those levied on goods or services used directly or indirectly in making the product;

"Cumulative" indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production;

"Remission" of taxes includes the refund or rebate of taxes;

"Remission or drawback" includes the full or partial exemption or deferral of import charges.

⁸⁸ The Members recognize that deferral need not amount to an export subsidy where, for example, appropriate interest charges are collected. The Members reaffirm the principle that prices for goods in transactions between exporting enterprises and foreign buyers under their or under the same control should for tax purposes be the prices which would be charged between independent enterprises acting at arm's length. Any Member may draw the attention of another Member to administrative or other practices which

- (f) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.
- (g) The exemption or remission, in respect of the production and distribution of exported products, of indirect taxes in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.
- (h) The exemption, remission or deferral of prior-stage cumulative indirect taxes on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior-stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior-stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior-stage cumulative indirect taxes are levied on inputs that are consumed in the production of the exported product (making normal allowance for waste).⁸⁹ This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II.
- (i) The remission or drawback of import charges⁵⁸ in excess of those levied on imported inputs that are consumed in the production of the exported product (making normal allowance for waste); provided, however, that in particular cases a firm may use a quantity of home market inputs equal to, and having the same quality and characteristics as, the imported inputs as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, not to exceed two years. This item shall be interpreted in accordance with the guidelines on consumption of inputs in the production process contained in Annex II and the guidelines in the determination of substitution drawback systems as export subsidies contained in Annex III.
- (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

may contravene this principle and which result in a significant saving of direct taxes in export transactions. In such circumstances the Members shall normally attempt to resolve their differences using the facilities of existing bilateral tax treaties or other specific international mechanisms, without prejudice to the rights and obligations of Members under GATT 1994, including the right of consultation created in the preceding sentence.

Paragraph (e) is not intended to limit a Member from taking measures to avoid the double taxation of foreign-source income earned by its enterprises or the enterprises of another Member.

⁸⁹ Paragraph (h) does not apply to value-added tax systems and border-tax adjustment in lieu thereof; the problem of the excessive remission of value-added taxes is exclusively covered by paragraph (g).

- (k) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and other credit terms and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

- (l) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994.
